



**COUNTY OF LOS ANGELES
DEPARTMENT OF AUDITOR-CONTROLLER**

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July 14, 2009

TO: Supervisor Don Knabe, Chairman
Supervisor Gloria Molina
Supervisor Mark Ridley-Thomas
Supervisor Zev Yaroslavsky
Supervisor Michael D. Antonovich

FROM: Wendy L. Watanabe
Auditor-Controller

SUBJECT: **PALMS RESIDENTIAL CARE FACILITY CONTRACT – FOLLOW-UP
REVIEW**

At the request of the Department of Public Health (DPH), Office of AIDS Programs and Policy (OAPP), we completed a follow-up review of Palms Residential Care Facility's (Palms or Agency) progress in implementing the 27 recommendations contained in our November 3, 2008 report. The purpose of our original review was to determine if Palms had appropriately spent funds in accordance with the County contract. Palms has two fixed-fee contracts with the County to provide HIV/AIDS residential care for the chronically ill and to treat substance abuse.

Results of Review

Palms made limited progress implementing the recommendations contained in our previous report that identified significant areas of non-compliance and Palm's limited capacity to account for program funds. The Agency did not implement 16 (60%) recommendations, partially implemented three (11%) recommendations, implemented six (22%) recommendations and two (7%) recommendations are no longer applicable.

During our current follow-up review of Palms, we identified new questioned costs totaling approximately \$40,000. DPH cannot recover the questioned costs because the fixed-fee contracts do not contain provisions that would allow the County to recover disallowed and undocumented expenditures. However, as indicated in our November 3, 2008 report, we believe that Palms is required to comply with the fiscal contract requirements, including spending program funds in program related services and

maintaining proper documentation. It should also be noted that many of the findings noted in this follow-up review were similar to the issues noted in the prior review. The following are examples of our findings. Palms:

- Did not document loans between Palms and the Executive Director and a related party. We noted two checks, totaling \$22,000, were made payable to the Executive Director and a relative and were signed by the Executive Director. Palms' management claimed the \$22,000 were loan repayments. However, Palms did not provide documentation to support these loans, i.e., loan agreements.
- Did not maintain documentation to support six (30%) of the 20 transactions reviewed for food purchases, professional services, and utilities, totaling \$9,709.
- Billed OAPP for non-OAPP program expenditures in eight (40%) of the 20 transactions reviewed. The disallowed expenditures related to training, repairs, cleaning, and food purchases, totaling \$7,561.
- Did not implement proper internal controls to reduce the risk of misappropriating program funds. For example, Palms management did not obtain two signatures on checks over \$10,000 as required by Palm's Board of Directors. In addition, the Executive Director signed checks payable to himself.
- Did not implement an integrated accounting system to ensure that all the Agency's financial transactions were recorded. For example, not all checks recorded in the Agency's check register were recorded in their general ledger. In addition, two checks that cleared the bank were recorded in Palms' accounting records for different amounts and payees.
- Did not hire qualified accounting staff to ensure accounting records and financial reports were prepared timely and accurately.

Palm's corrective action plan, issued in December 2008 in response to our November 2008 report, indicated that Palms implemented 20 of the 25 applicable recommendations. However, based on our review, only six of the 25 applicable recommendations were implemented and many of the significant procedural changes have not been made. Details of our review are attached.

Conclusion

Based on Palms' limited progress to implement the recommendations in our initial report that resulted in additional questioned costs, continued lack of internal controls over basic business processes and inaccurate accounting records, it is imperative that DPH require Palms to correct all fiscal deficiencies noted in our report within sixty days. This corrective action should include hiring a qualified fiscal agent or professional accounting

services. In the event Palms fails to correct all fiscal deficiencies, DPH should work with County Counsel to exercise the contractual remedies to terminate Palms' two existing residential care contracts.

Review of Report

We discussed the results of our review with Palms' management and OAPP on July 10, 2009. We also received Palms' response which we incorporated in our report.

We thank Palms management for their cooperation and assistance during the review. Please call me if you have any questions or your staff may call Maria Oms at (213) 974-8303.

WLW:MMO:JET:DC

Attachment

c: William T Fujioka, Chief Executive Officer
Jonathan E. Fielding, Director, Department of Public Health
Jonathan E. Freedman, Chief Deputy, Department of Public Health
Kevin Pickett, President/Executive Officer, Palms Residential Care Facility
Public Information Office
Audit Committee

**DEPARTMENT OF PUBLIC HEALTH
PALMS RESIDENTIAL CARE FACILITY CONTRACT
FOLLOW-UP REVIEW**

ELIGIBILITY

Recommendation 1

Palms management ensure client files contain documentation indicating that clients are screened for Medi-Cal, private medical insurance and other third party payers, as appropriate.

Current Status: Implemented.

Results

All 10 client files reviewed contained initial assessments for third party payers.

CASH

Recommendation 2

Palms management ensure bank reconciliations are properly prepared within 30 days of the bank statement date by someone with no cash handling or bookkeeping responsibilities and reviewed by an appropriate level of management.

Current Status: Not implemented.

Results

Palms attempted to reconcile their bank statements to their accounting records for January 2009 through May 2009. However, the reconciliations were not properly prepared. Specifically:

- Palms attempted to reconcile the cash balance listed on the monthly bank statements to the cash balance reported in the Agency's check register. However, the cash balance reported in the Agency's check register did not agree with the cash balance reported in the Agency's other accounting recordings. As a result, Palms can not guarantee that the check register cash balance is accurate.
- Palms reconciliations included dollar amounts that Palms could not explain. It appeared the dollar amounts were a "plugged amount" so that the cash balances between the monthly bank statements and the check register reconciled.

- The reconciliations were not signed by an appropriate level of management.

Palms Response

This condition came about because of the method of processing the accounting data. In an effort to maintain separation of duties the accounts payable was done from one location (Figueroa), payroll was computed from another location. Checks was received (copied) and deposited by a different individual. The bank reconciliations was done by a different outside contractor. Sometimes the activities of the different people didn't end up to the person that does the inputting to the accounting systems in a timely matter.

The Agency is in the process of going to a centralize accounting system from one centralized location (Figueroa). It will also improve the working relationship among the different personnel.

REVENUE**Recommendation 3**

Palms management ensure that all revenues received are deposited into the correct account and recorded in the Agency's financial records.

Current Status: Not implemented.

Results

Palms appropriately deposited \$7,103 and recorded the four deposits in a separate accounting fund. However, Palms did not record these amounts in their general ledger. As a result, Palms' general accounting records did not accurately report all transactions. In addition, Palms incorrectly classified in their accounting records a DPH payment as a donation.

Palms Response

The Agency is aware of the lapse of time between the receipt of the funds and the time of recording of them in the general ledger. With the bring most of the accounting functions into one location and the improvement of communications among personnel this finding should be fixed.

With the institute of new month end closing procedure misclassification of any income or expense should be discovered.

Recommendation 4

Palms management discontinue using resident fees for petty cash purchases.

Current Status: Implemented.

Results

Palms established a separate bank account for client fees and residents' funds. We reviewed the bank statements and deposit slips from January 2009 to June 2009 and verified that Palms deposited funds from program residents into the bank account.

EXPENDITURES**Recommendations 5 and 6**

DPH management work with County Counsel to amend the fixed-fee contracts to include language to allow the County to recover program funds related to disallowed and undocumented program expenditures.

DPH management determine the impact of the disallowed and undocumented expenditures on future Residential CARE Facility for the Chronically Ill rate adjustments.

Current Status: Not applicable to Palms.

Recommendation 7

Palms management repay DPH \$128,547, the amount of undocumented and unallowable program costs related to the cost reimbursement contracts.

Current Status: Partially implemented.

Results

To date Palms repaid DPH \$78,527. On June 22, 2009, OAPP approved Palms' request for a repayment plan for the remaining \$50,020. Palms agreed to repay DPH in eight monthly payments of \$6,252.50 starting July 2009.

Palms Response

It is evidenced by prior repayment and entering into an agreement to repay the balance in monthly payments that we accept the auditor's recommendation.

Recommendation 8

Palms management maintain supporting documentation for all OAPP expenditures including original vendor invoices and receipts.

Current Status: Not implemented.

Results

A review of 20 expenditure transactions from January to May 2009 totaling \$32,200 identified \$17,270 (54%) in questioned costs. In addition, Palms did not provide documentation to support \$22,000 in loan repayments. Specifically, Palms:

- Did not maintain documentation to support six (30%) of the 20 transactions reviewed. The undocumented program expenditures, related to food purchases, professional services, and utilities, totaling \$9,709.
- For eight (40%) of the 20 transactions reviewed related to non-OAPP program expenditures. The disallowed expenditures, related to training, repairs, cleaning, and food purchases, totaling \$7,561.
- Did not document loans between Palms and the Executive Director (and a related party). Two checks, totaling \$22,000, were made payable to the Executive Director and a relative and were signed by the Executive Director. Palms' management claimed the \$22,000 were loan repayments. However, Palms did not provide loan agreements.

Palms Response

The Agency have request the details of the above finding in order to further investigate what, who, why and how this occurred.

Recommendation 9

Provide an explanation for the possible altered invoices related to the facility maintenance and repair.

Current Status: Not implemented.

Results

Palms did not provided an explanation for the altered invoices that they provided in our initial review.

Palms Response

This finding is from four years ago (2005 and 2006) and we do not readily have the response to this finding. We were told that your review would go forward from January 1, 2009 to May 31, 2009.

Recommendation 10

Palms management ensure all independent contractors' agreements indicate the scope of services and deliverables, the number of hours to be worked, and an agreed upon rate of compensation.

Current Status: Not implemented.

Results

For the period of January to June 2009, Palms did not have written service agreements for two independent contractors that Palms indicated provided accounting and payroll services. In addition, the two additional service agreements for consultants providing nursing and quality management did not include the consultants' hourly rate of compensation as required.

Palms Response

The Agency will design a check list (a check request) to ensure that all the required documentation and signatures are to support the check request.

Recommendation 11

Palms management ensure all independent contractor payments are supported by time and attendance records. Also, invoices should detail the nature of services provided.

Current Status: Implemented.

Results

The two independent contractors' billings sampled were supported by attendance records and contained a detailed description of the services provided.

Recommendation 12

Palms management ensure mileage reimbursement claims include mileage logs showing dates, destination, the purpose of trip and mileage.

Current Status: Not applicable.

Results

The recommendation applied to Palm's Community Development Initiative and Faith Based Initiative contracts which expired in June 2008 and December 2008 respectively. Therefore, the recommendation is no longer applicable.

Recommendation 13

Palms management ensure supporting documentation for travel expenditures includes the date, purpose of trip, rates claimed and information detailing the purpose of the trip.

Current Status: Not implemented.

Results

Palms did not provide documentation to support \$6,786 in travel expenditures reported on their cost report for one of the two residential contracts (H700988) for the period ending February 2009.

Palms Response

This cost is for transportation of clients to and from various meeting, doctor visits, social services appointments, to locate permanent housing (apartments), etc. from March 1, 2008 to February 28, 2009. Cost is for fuel (\$ 150 per week), plus maintain and repairs to Agency Van.

Recommendation 14

Palms management ensure that only costs that are allowable, necessary, proper and reasonable for carrying out the purposes and activities of the OAPP program are charged to the program.

Current Status: Not implemented.

Results

As indicated for Recommendation 8, Palms charged the OAPP program \$7,561 for expenditures related to non-OAPP programs.

Palms Response

With the implementation of a new accounting month end close this finding should be fixed. The Agency will institute a new month end close where certain things are checked.

Recommendation 15

Palms management ensure that shared costs are reasonably distributed among the benefiting programs.

Current Status: Not implemented.

Results

Palms did not allocate shared program expenditures. Two (10%) of the 20 expenditures reviewed, totaling \$2,212, also benefited non-OAPP programs. However, Palms charged 100% of the expenditures to the OAPP program.

Palms Response

The Agency will follow up on this to ensure that OAPP is only charge it's fair share of cost that should be allocated

Recommendation 16

Palms management recalculate the lease amount based on acquisition cost in accordance with OMB Circular Letter A-122 and repay DPH any amounts over billed.

Current Status: Not implemented.

Results

Palms did not provide documentation to show they revised their lease payments in accordance with OMB A-122 requirements.

Palms Response

OMB Circular No. A-122 (Cost Principles for Non-Profit Organizations) paragraph 43(a) states that rental costs are allowable to extent that the rates are reasonable costs of comparable property. Paragraph 43(c) states that Rental Cost under "less-than-arms-length" leases are allowable only up to the amount that would be allowed had the title to the property vested in a the non-profit organization .

The Agency finds that the amount of the lease is a reasonable amount, therefore it is felt that DPH was not over billed.

CONTRACT COMPLIANCE AND INTERNAL CONTROLS

Recommendation 17

Ensure that OAPP funds are kept separate and not commingled with other funds.

Current Status: Not implemented.

Results

Palms incorrectly classified one (10%) of the 10 OAPP payments reviewed as a donation in their accounting records.

Palms Response

The new centralized accounting system have the capability to track the receipt and expenditures by program.

Recommendation 18

Establish a petty cash fund to pay for small incidental items and maintain documentation to support expenditures.

Current Status: Implemented.

Results

Currently, Palms issued checks to the employees for incidental purchases. The employees are required to submit receipts for the purchases to support the check amounts. The two checks reviewed issued to employees for incidental purchases were adequately supported with vendor receipts.

Recommendation 19

Implement an integrated accounting system to ensure that all the Agency's financial transactions are recorded.

Current Status: Not implemented.

Results

Palms did not provide financial records to support the financial activity listed on their Cost Reports submitted to DPH for the period ending February 2009. In addition, Palms' general ledger did not accurately report all business activity. For example:

- Not all checks recorded in Palms' check register were recorded in their general ledger.
- Two checks that cleared the bank were recorded in Palms' general ledger for different amounts and payees.
- As noted in Recommendation 3, not all revenue is accurately reported.

These exceptions were similar to the exceptions noted in our November 2008 report.

Palms Response

Palms did not respond to this not implemented recommendation.

Recommendation 20

Provide OAPP an explanation for the checks that were unrecorded or were recorded for the incorrect amounts.

Current Status: Not implemented.

Results

Palms did not provide an explanation for the unrecorded and incorrectly recorded checks identified in our November 2008 report.

Palms Response

The Agency believes that this result of our (prior) method of recording the Agency accounting data. With the centralization of the accounting functions and new checks and balance systems this should be fixes.

Recommendation 21

Establish a chart of accounts for classifying transactions by program and activity.

Current Status: Partially implemented.

Results

Palms' management provided a chart of accounts and they indicated they were in the process of classifying all expenditure accounts by program.

Palms Response

We do not concur with the auditor's assessment and have attached a copy of the chart of accounts from the Quick Books® accounting program which supports programs and activities. The programs are tracked as Classes in the Quick Books® accounting program. List of Classes are shown as a location since there are normally only one program at each location. If a locations have more that one program then it is assigned a different class.

Recommendation 22

Hire qualified accounting staff or obtain outside professional accounting services to ensure the accounting records and financial reports are prepared timely and accurately.

Current Status: Not implemented.

Results

As of June 24, 2009, Palms did not have qualified accounting staff preparing the Agency's accounting records. Palms' management indicated that prior to the start of our follow-up review, they terminated their existing contract with a Certified Public Accountant that had prepared Palms' accounting records since December 2008. According to Palms, the contract was terminated because the accountant did not have sufficient non-profit accounting experience. We were unable to confirm that the Agency hired an outside accounting firm since they did not provide documentation such as a copy of the terminated contract or payment invoices.

Palms Response

The Agency is seeking an outside Accountant (with nonprofit experiences) to provide accounting services on a monthly ongoing basis. That person should be in place no later than August 1, 2009.

Recommendation 23

Ensure the blank check stock is kept secured at all times.

Current Status: Implemented.

Results

On June 29, 2009, Palms blank check stock was appropriately locked in a file cabinet.

Recommendation 24

Require two signatures on all checks. Ensure that the second signer is someone independent from the cash receipts and disbursements processes.

Current Status: Not implemented.

Results

The March 3, 2009 Board of Director's minutes indicated that two signatures are required for checks over \$10,000. The two checks sampled, dated May 26, 2009, for \$20,000 each that were made payable to the United States Treasury, had only one signature.

Palms Response

The Agency concur with the (this) auditors finding/recommendations. The Agency has added another check signer to solve this problem. The Agency feel that to require two signatures on a check for a low amount (less than \$ xx,xxx.) would be an overkill. E.g. a Five Dollars check should not require two signatures.

Recommendation 25

Require Palms' Board of Directors to designate an alternate check signer, preferably a Board member other than the Director to sign checks issued to the Executive Director.

Current Status: Not implemented.

Results

The two checks sampled were issued to the Executive Director (\$15,000) and a relative (\$7,000) and were signed by the Executive Director. According to Palms' management, the checks were loan repayments. However, as noted in the Recommendation 8 section, Palms did not provide documentation to support the loan repayments.

Palms Response

We concur with the auditor's recommendations and have implement added another check signer to the bank account.

Recommendation 26

Ensure the Board of Directors is composed of directors in accordance with the California Corporations Code so that their oversight is independent and they can perform their fiduciary duties in an independent and objective manner.

Current Status: Implemented.

Results

The Board of Directors is composed in accordance with the California Corporations Code.

Recommendation 27

Palms management prepare a fixed asset/equipment listing to account for fixed assets and equipment purchased with OAPP funds.

Current Status: Not applicable.

Results

The Agency did not have any fixed assets that require to be listed on a fixed asset list. In addition, a review of their general ledger from January 2009 to May 2009 did not identify any fixed assets purchased.

PAYROLL AND PERSONNEL

Recommendation 28

Palms management submit revised 1099 Miscellaneous Income forms for Tax Years 2005 and 2006 to the appropriate federal and State agencies using the correct taxpayers' social security numbers and provide DPH with copies of the forms submitted.

Current Status: Partially implemented.

Results

Palms provided the Auditor-Controller with copies of revised 1099 Miscellaneous Income forms for 2005 and 2006. However, we are in the process of verifying that Palms submitted the revised 1099 Miscellaneous Income forms to the appropriate taxing authorities.

COST ALLOCATION PLAN

Recommendation 29

Palms management allocate expenditures on a monthly basis in accordance with its Cost Allocation Plan.

Current Status: Not implemented.

Results

As indicated above for Recommendation 15, shared costs are not always appropriately charged to Palms' programs. As a result, costs related to other programs were recorded to OAPP expenditure accounts on the general ledger.

Palms Response

The resulted from a misallocations. The Agency will institute a new monthly closing procedure within the next 15 days.